

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

RATE AND SERVICE CHANGES TO IMPLEMENT
FUNCTIONALLY EQUIVALENT NEGOTIATED
SERVICE AGREEMENT WITH BRADFORD GROUP

Docket No. MC2007–4

**INITIAL BRIEF OF THE
UNITED STATES POSTAL SERVICE**

UNITED STATES POSTAL SERVICE

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January 16, 2008

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I. INTRODUCTION

In 2006, the Commission took an important step forward in the evolution of Negotiated Service Agreements (NSAs) by approving the Postal Service's request for an NSA with Bookspan in Docket No. MC2005-3. The Bookspan NSA was the first NSA to feature declining block rates for Standard Mail, rather than First-Class Mail, and to involve an NSA partner that was not a financial services institution. Moreover, the Bookspan NSA generated new volumes and new revenue, not only in Standard Mail, but in various other classes of mail, including First-Class Mail and Bound Printed Matter, via Bookspan's multiplier effect. In short, the implementation of the Bookspan NSA has successfully allowed the Postal Service to expand the scope of NSAs to other subclasses of mail and to other types of prospective customers.

Thus, in 2007 the Postal Service was able to reach an agreement with The Bradford Group, a nationwide collectibles retailer, to provide declining block rates for Bradford Group Standard Mail letters and flats soliciting new and existing customers for Bradford Group collectibles and other gift items. The Bradford Group, much like Bookspan, features a significant multiplier effect through additional First-Class Mail and Standard Mail correspondence, fulfillment, and additional solicitations.¹

The Bradford Group NSA was initially proffered as functionally equivalent to the Bookspan NSA, though the Commission chose to examine the agreement under the

¹ Additional information about The Bradford Group's business, its multiplier effect, and the provisions of the Bradford Group NSA can be found in The Bradford Group's Initial Brief and are adopted by the Postal Service as background for its arguments herein.

rules for baseline agreements.² Nevertheless, the Commission's rules provide that for all NSAs "it shall be the policy of the Commission to recommend Negotiated Service Agreements that are consistent with statutory criteria, and benefit the Postal Service, without causing unreasonable harm to the marketplace."³ The record in this docket demonstrates that the co-proponents have met their burden of showing that the requested rates and classifications are consistent with applicable statutory criteria and will clearly benefit the Postal Service. The risk of miscalculation of such benefit is almost completely mitigated by various risk-mitigation provisions of this NSA, which were also featured in the Bookspan agreement. In addition, this NSA satisfies the parameters of the "Panzar" test.

The record evidence also demonstrates that, given The Bradford Group's unique place in the market, there is virtually no risk in regard to unreasonable harm. No participant has filed factual evidence or analyses that contradict the facts and analyses presented by the Postal Service and The Bradford Group and tested in written cross-examination. Therefore, on the basis of the record created, as well as applicable criteria in the Postal Reorganization Act, the Commission should recommend the changes requested to implement the NSA with The Bradford Group.

² Order No. 32, Docket No. MC2007-4 (September 7, 2007)

³ 39 C.F.R. § 3001.190(b).

II. PROCEDURAL HISTORY

On August 3, 2007, the Postal Service filed its Request for a recommended decision to implement a functionally equivalent Negotiated Service Agreement (NSA) with Bradford Group.⁴ On August 8, 2007, the Commission issued its Notice and Order on the filing of the Request, and stated that a final determination regarding the appropriateness of characterizing the Bradford Group NSA as functionally equivalent to the Bookspan NSA would be made after the prehearing conference. The Commission designated Kenneth E. Richardson, Acting Director of the Commission's Office of the Consumer Advocate (OCA), to represent the general interests of the public, and the Commission elected to sit *en banc* in this proceeding.⁵

The following parties intervened in the case: American Catalog Mailers Association; David B. Popkin; Pitney Bowes Inc.; Valpak Dealers' Association, Inc.; and Valpak Direct Marketing Systems, Inc.

On August 20, 2007, the Commission granted the Postal Service Motion to establish settlement procedures in this docket, and appointed Postal Service counsel as settlement coordinator.⁶ A settlement conference was held on August 28, 2007, immediately prior to the prehearing conference. At the settlement conference, the parties were able to discuss likely areas of discovery, and even though settlement was considered unlikely, the discussions were productive.

⁴ Request of the United States Postal Service for A Recommended Decision on Classifications and Rates to Implement A Functionally Equivalent Negotiated Service Agreement With Bradford Group, Docket No. MC2007-4 (August 3, 2007).

⁵ Order No. 23, Docket No. MC2007-4 (August 8, 2007).

On September 7, 2007, the Commission ordered that the Bradford Group NSA would be considered as a new baseline NSA, rather than functionally equivalent to Bookspan. The Commission noted a few distinctions between the Bookspan and The Bradford Group agreements in its Order, but nevertheless established a procedural schedule that provided significant expedition in litigating this case as a baseline NSA.⁷

Although the official date for the end of discovery on the proponents' direct cases was September 10, 2007, the conclusion of follow-up discovery was delayed due to a pending Joint Motion for protective conditions for responses to outstanding interrogatories from the OCA.⁸ Ultimately, the co-proponents withdrew the Joint Motion on November 16, 2007, and agreed to publicly file a response to the outstanding interrogatories.

Thereafter, no participant requested a hearing or filed testimony rebutting the co-proponents' cases. On December 21, 2007, the Commission issued a final procedural schedule, establishing a January 16, 2008, deadline for filing initial briefs, and a January 30, 2008, deadline for filing reply briefs. The evidentiary record closed on January 11, 2008.⁹

(...footnote continued)

⁶ Order No. 28, Docket No. MC2007-4 (August 20, 2007).

⁷ Order No. 32, Docket No. MC2007-4 (September 7, 2007).

⁸ Joint Motion of the United States Postal Service and Bradford Group for Protective Conditions for Materials Requested in OCA/USPS-T1-19(c), 20, 21(c), 21(f), 21(i), and 22, September 20, 2007 (Initial Joint Motion); Joint Motion of The Bradford Group and United States Postal Service for Protective Conditions in Response to Commission Order No. 38 (OCA/USPS-T1-19(c), 20, 21(c), 21(f), 21(i), and 22), October 26, 2007 (Renewed Joint Motion).

⁹ Order No. 51, Docket No. MC2007-4 (December 21, 2007).

III. THE COMMISSION SHOULD RECOMMEND THE CLASSIFICATION AND RATE CHANGES NEEDED TO IMPLEMENT THE NSA

A. The NSA Will Increase Mail Volume and Generate Revenues at Higher Levels than Would Be Achieved in its Absence

The Bradford Group NSA is designed to provide incentives to The Bradford Group to increase its use of Standard Mail letters and flats. The Bradford Group's Standard mail letters and flats volumes are expected to be flat or falling in the absence of discounts.¹⁰ This NSA provides incentives to The Bradford Group via declining block rates for Standard Mail letters and flats soliciting new and existing customers for The Bradford Group collectibles and other items. As explained by Postal Service witness Parr (USPS-T-1), the declining block rates will encourage The Bradford Group to mail additional solicitation letters and flats, thereby increasing its customer base.¹¹

For example, in Year 1 of the agreement, The Bradford Group's Before-Rates volume forecast is projected to be 146,500,000 Standard Mail letters and 53,500,000 Standard Mail flats. The Year 1 volume commitments require The Bradford Group to mail 154,000,000 Standard Mail letters and 54,500,000 flats before receiving any discounts. As shown in the table below, The Bradford Group will be provided with incrementally higher discounts based on increased Standard Mail letters and flats volume.¹²

¹⁰ Direct Testimony of Broderick A. Parr on Behalf of the United States Postal Service, USPS-T-1 at 1.

¹¹ USPS-T-1 at 2.

Year 1 Structure					
LETTERS			FLATS		
Before-Rates Volume Forecast:			53,500,000		
LETTER Volume Blocks		Incremental Discount	FLATS Volume Blocks		Incremental Discount
147,000,000	157,000,000	1.5 cents	53,500,000	55,500,000	1.0 cents
157,000,001	167,000,000	2.0 cents	55,500,001	57,500,000	1.2 cents
167,000,001	177,000,000	2.5 cents	57,500,001	59,500,000	1.5 cents
177,000,001	183,000,000	3.0 cents	59,500,001	61,500,000	2.0 cents
Volume Commitment:			54,500,000		

Source: USPS-T-1 at 3

The Bradford Group NSA generates revenue for the Postal Service from the additional contribution created by an increase in The Bradford Group's Standard Mail letters and flats. As detailed by witness Parr's financial model, the total estimated net financial benefit to the Postal Service over the three-year period of this NSA is \$5.4 million. Moreover, through a "multiplier effect," the Bradford Group NSA would generate additional revenue to the Postal Service via increased First-Class Mail and Standard Mail correspondence, fulfillment, and additional solicitations sent to newly-obtained

(...footnote continued)

¹² USPS-T-1 at 2-3.

Bradford Group customers.¹³ The Bradford Group NSA is thus tailored to increase mail volume and generate revenue that would not be achieved in its absence.

B. The NSA Is Structured to Mitigate Risk and Provide Maximum Protection to the Postal Service

Much like the Bookspan NSA, the Bradford Group NSA incorporates several features which protect the Postal Service in the event of changed circumstances and any other unintended consequences.

1. Volume commitments

This NSA imposes volume commitments that must be met, in each year of the agreement, before discounts are paid. The volume commitments are set well above the first declining rate block threshold in order to reduce the risk of discount leakage from variations in before-rates forecasts.¹⁴

2. Volume commitment adjustments

In the event that volumes differ significantly from those forecast, the NSA provides mechanisms to adjust the subsequent year's volume commitment, based on a specified formula.¹⁵ For example, if at the end of Year 1, the actual volume of Standard Mail letters reached 175,000,000 pieces, the Year 2 volume commitment would increase from 154,000,000 to 164,500,000 letters. Thus, The Bradford Group would have to mail 164,500,000 letters in Year 2 in order to receive the discounts provided for volumes above 147,000,000 letters. Similarly, for Standard Mail flats, if at the end of Year 1, the actual volume reached 65,000,000 pieces, the Year 2 volume commitment

¹³ USPS-T-1 at 2.

¹⁴ Id.

would increase from 55,500,000 to 60,250,000 flats. Thus, The Bradford Group would have to mail 60,250,000 flats in Year 2 in order to receive the discounts provided for volumes above 54,500,000 flats.

3. Automatic termination

By its own terms, and without the need for action by the Postal Service, the NSA automatically terminates if The Bradford Group's Standard Mail letters volume exceeds 195,000,000 in any year of the agreement, or if Standard Mail flats volume exceeds 73,500,000 in Year 1, 74,500,00 in Year 2, or 77,000,000 in Year 3 .¹⁶ It is important to note that a sizeable increase in *either* letters or flats would trigger the automatic termination provision for the entire agreement, which provides the Postal Service with additional protection against unforeseen risks. For example, if The Bradford Group were to experience a change in circumstances which unexpectedly increased its Standard Mail letter volume beyond the 195,000,000 trigger, incentives would be deemed to be no longer needed and discounts would no longer be payable for both letters and flats.

4. Unconditional withdrawal

Each party has an unencumbered right to terminate the agreement, upon thirty days' written notice to the other party.¹⁷ This protects the Postal Service from any unintended outcomes, and provides an opportunity to foreclose loss of revenue that would otherwise be obtained.

(...footnote continued)

¹⁵ USPS-T-1 at 5-6.

¹⁶ USPS-T-1 at 7.

C. Witness Parr's Financial Model Demonstrates that the NSA Will Benefit the Postal Service and Therefore All Ratepayers

Using the volume projections developed by The Bradford Group and reviewed by the Postal Service, witness Parr performed a financial analysis, which demonstrates the value of the NSA to the Postal Service to be approximately \$5.4 million over the three years of the agreement.¹⁸ In addition, witness Parr performed a sensitivity analysis which demonstrates that the risks of financial loss from swings in estimated volumes are extremely low.¹⁹

Moreover, as is consistent with the financial model used in the Bookspan NSA, witness Parr's financial model does not include the benefits of The Bradford Group's multiplier effect. The additional First-Class Mail, Standard Mail, fulfillment, and other revenues generated from this agreement would be in addition to the \$5.4 million estimate. Finally, USPS-LR-L-1, MC2004-3 Opinion and Further Recommended Decision Analysis for the Bradford Group NSA, demonstrates that the proposed NSA satisfies the parameters of the "Panzar" test.

D. The Requested Rates and Classifications are Consistent with the Statutory Criteria

As witness Parr details, the proposed changes in classifications and rates satisfy the rate and classification criteria of the Postal Reorganization Act.²⁰ As demonstrated by the financial model, the rates resulting from the NSA cover attributable costs and

(...footnote continued)

¹⁷ USPS-T-1 at 13.

¹⁸ USPS-T-1, Appendix A.

¹⁹ USPS-T-1, Appendix B.

²⁰ USPS-T-1 at 16-18; 39 U.S.C. §§ 3622(b) and 3623(c).

make a reasonable contribution to the other costs of the Postal Service, thus benefiting all mail users.²¹ By negotiating directly with a customer, the rates may more accurately represent the value that the user places on the service provided, which is desirable to both the mailer and the Postal Service.²² Finally, the rates and classifications are fair and equitable, and no customer or competitor is harmed.²³

E. There Is No Unreasonable Harm to Competition

Witness Parr examined the market within which The Bradford Group operates, including its competitors' use of various marketing media. The Bradford Group is unique in that, as a nonstore retailer, it relies on the mail as a primary means of marketing, in addition to order fulfillment. As witness Parr explained, The Bradford Group's competitors, who rely on other forms of advertising, already have the ability to negotiate price terms with their suppliers. Thus, this NSA may serve to rectify a competitive disadvantage for The Bradford Group. In addition, any competitor that intends to increase its use of advertising mail may negotiate a comparable agreement to this NSA. Therefore, this NSA is not expected to have any significant effect on competition in The Bradford Group's marketplace.²⁴ Moreover, competitors of the Postal Service are not affected because The Bradford Group already relies almost totally on the Postal Service.²⁵

²¹ §§ 3622(b)(3), (4); 3623(c)(4).

²² §§ 3622(b)(2), 3623(c)(5).

²³ USPS-T-1 at 18.

²⁴ USPS-T-1 at 14.

²⁵ USPS-T-1, at 15.

F. No Discrimination Results from this Agreement Because Functionally Equivalent Agreements Are Available to Any Similarly Situated Customer

Because the Commission chose to analyze this NSA under the rules for baseline NSAs, it is important to note that even though The Bradford Group is relatively unique as a nonstore retailer specializing in collectible items, there is the possibility that other mailers might qualify for a functionally equivalent agreement. In that case, the Postal Service would seek to negotiate NSAs that reflect such mailers' circumstances and provide benefits similar to those in the Bradford Group NSA.

IV. CONCLUSION

For the reasons set forth above, the Postal Service respectfully urges the Commission to recommend the proposed NSA and adopt the classification language and rates set forth in Attachments A and B to the Postal Service's Request.

Respectfully submitted,

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